AN INVESTIGATION OF FACTORS INFLUENCING SUSTAINABILITY OF MICRO FINANCE INSTITUTIONS

[A CASE STUDY OF NAROK COUNTY]

BY

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DECLARATION

Declaration by student

This research project is my original work and has not been presented to any other institution of higher learning.

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BAEC/042/2012

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DATE…..

DEDICATION

To all Micro finance operators who made it possible for me to achieve all that I have achieved through continuous encouragement and support.

Further dedication is to my parents Simon Muriithi and Margaret Wanjiku for their sacrifice in educating me and for teaching me the discipline and value of hard work when I least knew the world.

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ABSTRACT

Micro finance institutions refer to small, saving and insurance services extended and economically disadvantaged segment of society. In the past ten years micro finance is emerging as powerful tool of growth in Kenya economy. This has resulted from increasing success in terms to reach the poor and sustaining delivery services. However large number of those engaged in microfinance services continue to struggle with sustainability. The research sought to establish the factors affecting the sustainability of microfinance institutions in Kenya and how they can be solved to promote success, stability and better performance of micro finance institutions. The study was therefore discover how the factors such as credit risks, geographical coverage, financial regulations, number of clients and management affect the sustainability of MFIs.

Descriptive research design was used to outline the features of the population in interest to come up with predictions. The questionnaires were physically delivered to the micro finance operators to fill and were collected later. The study found that financial regulations, geographical coverage and volume of credit transacted were the factors that highly affected the sustainability of microfinance institutions. These factors contribute positively or negatively to the sustainability of the microfinance institutions. The study concludes that sustainability of MFIs is a function of related and interconnected factors. The study recommends MFIs to open many branches to reach as many people as possible and ensure they conform to rules and regulation.

Table of Contents

DECLARATION ii
DEDICATION iii
ACKNOWLEDGEMENT iv
ABSTRACT v
LIST OF TABLES viii
LIST OF FIGURES ix
LIST OF ABBREVIATIONS x
CHAPTER 1 1
1.0 INTRODUCTION 1
1.1 Background of the Study 1
1.2 PROBLEM STATEMENT 3
1.3 OBJECTIVE OF THE STUDY 4
  1.3.1 General Objectives 4
  1.3.2 Specific objectives 4
1.4 Research question 4
1.5 Justification of the study 4
1.6 Definition of terms 4
CHAPTER 2 6
2.0 LITERATURE REVIEW 6
2.1 Introduction 6
2.2 Theoretical framework 6
  2.2.1 Resource Based View 6
  2.2.2 Dynamic Capabilities Theory 6
  2.2.3 Strategic Balancing theory 7
2.3 Micro finance definitions 7
  2.3.1 Microfinance Institutions in Kenya 8
2.4 Sustainability of Microfinance Institutions. 9

2.4.1 Financial Regulations. 9
2.4.2 Credit Risks 11
2.4.3 Geographical Spread and Outreach 12
2.4.4 Breadth of Outreach of Microfinance Institution 13
2.4.5 Depth of Outreach of Microfinance Institution 14
2.5 Conceptual framework 14
CHAPTER 3 16
3.0 METHODOLOGY 16
3.1 Introduction 16
3.2 Research Design 16
3.3 Population of study 16
3.4 Sample Size 16
3.5 Data Collection Instruments 17
3.6 Data Collection Methods 17
3.7 Data Analysis 17
3.8 Data analysis techniques 18
CHAPTER 4 19
4.0 DATA ANALYSIS RESULTS AND DISCUSSION 19
4.1 Introduction 19
4.2 General Information 19
4.3: Financial Regulations 25
4.4 Credit Risk 28
4.5: Geographical coverage 30
4.6 Regression Analysis 33
CHAPTER 5 37
5.0 SUMMARY, CONCLUSION AND RECOMMENDATIONS 37
5.1 Introduction 37
5.2 Discussion 37
5.3 Conclusions 38
5.4 Recommendations 38
5.5 Recommendations for Further Research 39

REFERENCES 40
APPENDICES 43

LIST OF TABLES

Table 4.1: The gender of the respondent**.**

Table 4.2: The age of the respondents.

Table 4.3: Duration the firm has been in operation in Kenya**.**

Table 4.4: Duration the Firm has been in Operation in Narok Town.

Table 4.5: Mode of maintaining the records.

Table 4.6: Donors of the Institutions

Table 4.7: Size of MFIs in Terms of Value Assets.

Table 4.8: The regulations that Governs the microfinance Institutions in Kenya

Table 4.9: Extent that the government policies contribute to the sustainability of the institution

Table 4.10: level of credit experience in terms of years

Table 4.11: Concentration of NPLs in Percentage.

Table 4.12: Number of clients that MFIs had by the end of the first Year of operation.

Table 4.13: Number of Clients currently.

Table 4.14: Model Summary.

Table 4.15: ANOVA[a]

Table 4.16: Coefficients.

LIST OF FIGURES

Figure 2.1: Conceptual Framework

Figure 4.1: gender of the respondent.

Figure 4.2: Age of the respondent.

Figure 4.3: Duration the firm has been in operating in Kenya.

Figure 4.4: Duration the firm has been in operation in Narok town.

Figure 4.5: Mode of maintaining the records.

Figure 4.6: Financer of the Institutions.

Figure 4.7: size of the institution in terms value asset.

Figure 4.8: The regulation that governs the microfinance institutions in Kenya.

Figure 4.9: Extent the Government policies contribute to the Sustainability of MFIs.

Figure 4.10: Level of credit experience in terms of years.

Figure 4.11: concentration of NPLs.

Figure 4.12: Number of clients that the MFIs had by the end of the first Year of operation.

Figure 4.13: Number of clients currently.

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LIST OF ABBREVIATIONS

MFIs- micro finance institutions

NPLs- non performing loans

CRB- credit reference bureaus

SACCOs- saving and credit societies

CHAPTER 1

1.0 INTRODUCTION

1.1 Background of the Study

Micro finance refers to all types of financial intermediation services savings, credit funds transfer, insurance pension remittances, provided to low income households and enterprises in both urban and rural areas including employees in the public and private sectors and self- employed.

The important role of financial intermediaries is fostering economic development. They offer loans and/or technical assistance in business development to low-income community in developing countries (Hartungi, 2011). Microfinance offers financial services to those who are poor and make it an important tool of poverty alleviation in many parts of the world. It is one of the most important tools to help to solve this problem and bridge the gap for the poor.

MFIs have a variety of products including micro loans, savings and other deposit products, remittances and transfers, payment services, insurance, and any other financial product or service that a commercial bank does not offer to low-income clients in the banking system (Hoque and Chisty, 2011). In the world over provision of microfinances to the low income group has been considered an innovative and sustainable approach to youth financial and micro enterprise activities empowerment leading to generation of income so as to improve their livelihoods and contribute to economic growth.

Micro finance institution being an important role as a vehicle for economic development. Chauka and Harkawat (2012) have reported that huge number of resident in developing countries have gained access to mainstream financial services through microfinance programs. With the ongoing developments in microfinance, there is considerable interest for many MFIs in Africa to keep pace with the changing landscape in the industry (Gupta, 2008). However, MFIs have continuously faced many challenges including lack of proper regulatory environment and lack of funds.

Microfinance institutions (MFIs) target the poor through innovative approaches which include group lending, progressive lending, regular repayment schedules, and collateral substitutes. However, despite the series of financial sector reforms that African countries have undertaken

since 1980s, financial system still exhibit substantial degree of inefficiencies in their saving mobilization and allocation of resources in productive activities (Senbet and Otchere 2012).

According to research majority of poor have no access financial services. Robinson estimates that about 90 percent of the people in developing countries have no access to institutional financial services (Robinson, 2001, 9). MFIs seek to reach as many poor people as possible in the long run to fulfill their goal to fight against the worldwide poverty, it has become clear that this outreach is only possible on a sustainable and efficient basis.

A micro finance institutions is said to have reached sustainability when the operating income from the loan is sufficient to cover all operating costs [Sharma and Nepal, 1997]. This definition adopts the bankers' perspective and sticks to accounting approach of sustainability. However Shah [1999] adopts for integrated approach in defining the term sustainability as the accounting approach to sustainability that takes into account the financial aspect of the institution is too narrow.
For Shah, the concept of sustainability includes obtaining funds at market rate and mobilization of local resources. Therefore, performance assessment criteria for financial viability of any microfinance related financial institutions are repayment rates, operating cash ratio, market interest rates, portfolio quality and demand driven rural credit system in which farmers themselves demand loans for their project. It has been argued that unsustainable MFIs will not help the poor in the future because the MFIs will be gone (Schreiner, 2000). Thus, it is better not to have MFIs than having unsustainable ones indicating how important the sustainability of MFIs is (Ganka, 2010).

1.2 PROBLEM STATEMENT

Microfinance is one of the practical development strategies and approaches that should be implemented and supported to attain the economic growth in a country. Robinson, (2011) states that MFIs provide credit, saving and other basic micro financial services to the poor and low income earning clients. Therefore micro finance is regarded as one tool to promote the capability of the low income people to engage in sustainable production activities leading to economic growth and improved social welfare.

While MFIs is widely viewed as a possible solution to the financing problems of smaller firms and micro-businesses the performance of the institutional sustainability seem not encouraging. This indicates that there is a little connection between micro finance and their growth. The growth of MFIs can be attributed to the factors such as, their contribution to social welfare, job creation and general economic and improvement of lives of the poor. However, despite interest in sector and subsidies that have flowed into the institutions, it appears challenging to make the MFIs viable for a long term. One survey found that according 30% of domestic micro finance programs operating in 2001 were either no longer in operation or were no longer lending capital 2 years later.(Bhatt, Painter and tang, 2002). Microfinance are thus faced with difficulty in its operations without reliance on grants, external fundraising or other subsidies. Even though, the expansion of micro finance institutions is a good sign of poverty alleviation, things may not change if institution do not have policies to promote sustainability in the performance in all its operations.

The microfinance in institutions in Kenya has been extensively studied; on the issue of sustainability which involved impact of mobile banking on micro finance (Nzioka, 2010). Sustainability strategies adopted by KARI (Gicobi, 2006). Regulation of microfinance (Ndulu, 2008). Majority of the previous studies have concentrated in impact of MFIs on poverty alleviation in the economy. This has provided little or no research on factors affecting sustainability of microfinance institutions in Kenya. The study is conducted to establish factors affecting sustainability of micro finance institutions.

1.3 OBJECTIVE OF THE STUDY

1.3.1 General Objectives

To investigate the factors affecting the sustainability of microfinance institutions in Narok county

1.3.2 Specific objectives

- To find out how financial regulations influence sustainability of microfinance institutions.
- To investigate how credit risks influence sustainability of microfinance institutions.
- To find out how geographical spread affects sustainability of microfinance institution.

1.4 Research question

1. How does financial regulations influence sustainability of micro finance institutions?

2. How does credit risks affects sustainability of micro finance institutions?

3. How does geographical spread affect sustainability of microfinance institutions?

1.5 Justification of the study

The study is relevant in the following aspects; the study is to assist in the formulation and implementation of better financial regulations that will consequently improve the sustainability of micro-finance institutions. It will help in determining the credit worthiness of the borrowers which will increase the MFIs liquidity lending. The study will also help the government to put in place and implement strong regulatory measures that will maintain sustainability of MFIs. Through the findings the society will be able to appreciate the areas of innovation to support the MFIs sustainability in the provision of services. Also the study will provide a source of reference for further studies on micro finance institutions.

1.6 Definition of terms

1 .Micro finance –This refers to all types of financial intermediation services , savings , credit funds transfer ,insurance ,pension remittances, provided to low income households and enterprises in both urban and rural areas including employees in the public and private sectors and the self-employed.

2. Micro-Enterprise-Refers to a privately owned firm of small capital and a few number of employees usually not more than 50.

3. Sustainability-Refers to the ability of a microfinance institution to cover all of its costs through interest and other income paid by its clients.

4. Micro finance institution-Refers to an organization that offers financial services to the poor. They are also specialized providers of financial services to the micro-enterprises.

CHAPTER 2

2.0 LITERATURE REVIEW

2.1 Introduction

This chapter discuss the literature concerning the factors affecting sustainability of micro finance institutions in Kenya. This review of literature explores the framework for this study and highlights the previous studies that help in identifying the gap of the literature. The literature presents the key factors affecting the sustainability of MFIs.

2.2 Theoretical framework

This study was based on the resource based view theory, dynamic capability theory and theory of strategic balancing as it seek to establish the strategic factors affecting sustainability of microfinance institutions in Kenya.

2.2.1 Resource Based View

The resource based view of the firm is a theory that has been explored as a means of explaining competitive advantage and superior performance amongst firms. Barney (1991), asserts that a firm is said to have a competitive advantage when it is implementing a value-creating strategy not simultaneously being implemented by any current or potential competitors. This competitive advantage is sustainable if the advantage resists erosion by competitor behavior. (Bharadwaj *et al.*, 1993). Fahy’s (2000, p. 99) model demonstrates the relationship between the firm’s key resources and the role of management in converting these resources into positions of sustainable competitive advantage, leading to superior performance in the market place.

2.2.2 Dynamic Capabilities Theory

This is the capability of an organization to purposefully adapt an organization’s resource base**.** According to Teece et al (1997) state that it’s the firm ability to integrate, build and reconfigure internal and external competence to address rapidly changing environments. Business has entered a new era of hyper-competition in which competition is violent and intense (D'Aveni, 1994). In order to sustain competitive advantage, business firms must continually reconfigure internal resources and capabilities to assume corporate responsibility for adapting turbulent environment.

Dynamic capabilities is a firm's strategy to constantly integrate, reconfigure, renew, and recreate internal and external resources in response to dynamic and rapidly shifting market environments in order to attain and sustain competitive advantage (Winter, 2003). Dynamic capabilities can explain how business firms create, define, discover, and exploit entrepreneurial opportunities in complex and volatile external environments in search for a strategic matching of resources and market needs (Teece, 2007).

2.2.3 Strategic Balancing theory

The strategic balancing focuses on the principle that the strategy of a company is partly equivalent to the strategy of an individual. The performance of companies is influenced by the actor's behaviour, including the system of leader values (Collins et al., 1997). This gives room to various configurations of alliances, which disappear only if the alliance swings towards a majority of poles of confrontation. Competitive strategy should focus on the management-needs identification process and a number of companies have achieved this. According to Hammer and Champy (1993) applied the key intelligence topics process in order to identify and prioritize the key intelligence needs of senior management and the organization itself. Thus, intelligence operations were effective and appropriate intelligence was produced. This approach enables corporate intelligence staff to identify strategic issues and in turn senior management can ensure that actionable intelligence results.

2.3 Micro finance definitions

The definitions of microfinance institutions has been proposed by scholars and organizations are seemingly different but the facts of the definitions is usually the same. According to Ledgerwood (1999) and Robison (2001), microfinance is defined as the provision of financial services generally in the form of credits, savings and insurance to low income individuals. Robinson (2001) refer the micro finance as small scale finance primarily credit and savings. Micro finance is the provision of small scale financial services to low income or unbanked people (Hartarska, 2005). It is about provision of a broad range of financial services such as deposits, loans payments money transfer and insurance to the poor and low income households and their farm or non-farm micro finance enterprises (Mwenda and Muuka, 2004 p.24).

According to the Asian development bank (ADB) defines as the provision of broad range of financial services such as deposit, loans payments services, money transfer and insurance to poor and low income households and their micro entrepreneurs(ADB, 2000) In addition to financial intermediation, some microfinance institution provide social intermediations services which involves group formation, development of self-confidence, financial training literacy management capabilities among members of group intended to benefit low income women and men (Ledgerwood, 1999).

According to Basu et al. (2004) MFIs complement effectively the formal banking sector in the provision of financial services to the low income population. The rationale of improving finance comes from the premises that empowerment of the poor through creating income generating capacity that enables the poor to access the all development required to get multifaceted dimensions of poverty and reduce their vulnerability to unexpected events.

2.3.1 Microfinance Institutions in Kenya

According to Nyanjwa (2008) the finance sector in Kenya was served by 43 commercial banks, 96 foreign exchange bureaus, 2 mortgage finance institutions, 5122 Savings and credit societies (SACCOS), 6 development finance institutions and 34 Microfinance institutions. The Microfinance sector in Kenya is currently serving 6.5 million people with outstanding loans of US $ 310 million (amfikenya.com). Nyanjwa (2008) stated that Microfinance in Kenya is carried out by institutions with varied forms including companies, cooperative societies, trusts, Non-governmental organizations (NGOs) state corporations and informal operators.

According to Omino (2005) there are over 100 organizations in Kenya including 50 Non-Governmental organizations (NGOs) which practice some form of Microfinance. 20 of these organizations practice pure Microfinance while the rest practice Microfinance alongside social welfare activities. Kithinji (2002) asserts that Kenya has had more exposure to microfinance than any other country in Sub-Saharan Africa, with micro-credit programmes dating back to the early 1980s. The Microfinance sector is licensed and regulated by the Central Bank according to the Microfinance Act (GOK, 2006). According to Ndulu (2010) the Microfinance sector regulation has adopted a 3 tiered approach which comprised a prudential regulation and supervision for deposit-taking institutions by the Central bank, a non-prudential regulation for credit only by the Ministry of Finance and finally no regulation for ROSCAs and ASCAs.

2.4 Sustainability of Microfinance Institutions.

In micro-finance, sustainability can be considered at several levels of institutional, group, and individual and can relate to organizational, managerial, and financial aspects (RAO, 2001).The issue of financial sustainability of microfinance institutions has attracted more attention in mainstream analysis at the expense of the sustainability of the client/borrower. MFIs face an apparent tension between achieving financial suitability and contribution to poverty reduction.

Sustainability thus refers to the ability of MFIs to cover all its costs from its own generated income from operations (Thapa *et al*., 1992) without depending on external support or subsidy. Financially sustainable MFI's can become a permanent part of the financial system as they continue to operate even after grants or soft loans are no longer available. This is because donors lacks near adequate funds to meet the global demand for microfinance. But when an MFI becomes sustainable, it is no longer limited to donor funding. It can be able draw on commercial funding sources to finance massive expansion of its outreach to poor people. The statistics proves that microfinance can be done sustainably even with very poor clients.

Microfinance institutions is said to have reached sustainability when the operating income from the loan is sufficient to cover all the operating costs [Sharma and Nepal, 1997].The performance assessment criteria for the financial viability of any microfinance institutions are repayment rate, opening cost ratio, market interest rates, portfolio quality and demand driven rural systems in which farmer's demand loan for their project. Thus, sustainability of microfinance institutions includes both financial viability and institutional sustainability of the lending institution [Sharma and Nepal 1997].

2.4.1 Financial Regulations.

Regulation of the microfinance sector is expected to lead to high quality growth, broaden the funding base for MFIs eligible to mobilize and administer deposits, credit facilities, other financial services, and initiate the process of integrating these institutions into the formal financial system. The regulation of the MFIs will enable authorities to define procedures for their operations, entrance, exit, and ultimately create an environment for fair competition and efficiency in the sector.

According to Arysad [2005] on sustainability of MFI's in Indonesia, Using a case study on village credit institutions he found that growing economy and supporting government policy at all levels through provision of a legal basis for the MFI and central bank regulations has contributed to success and growth of the MFI's. [Yaron 1994, Christen 1998] based on the necessary conditions of sustainable MFI proposed by some scholars concluded that such credit institution have been sustainable and by that implication they had positive net social benefits for their clients.. To be sustainable, MFI's must charge high interest rates. Clients willingly pay these rates because they value the services so highly. When governments enforce interest rate Caps, MFI's cannot charge enough to be sustainable.

Regulation and supervision ensure that MFI's run smoothly and cases of clients losing their money due to fraud are minimized. Some MFI`s need more funds to lend out through their micro credit operations. The MFIs are regulated in order to be allowed to offer bank accounts to hold their savings. Other NGO`s believe that regulation will prosper their business and improve their operations. Some will want to be licensed in order to expand their services so that they can provide to the poor.

In Kenya, the microfinance act became operational in May 2008 address licensing provisions minimum capital requirement, minimum liquid asset, submission of accounts to the CBK, supervision by the central bank, limits on loan and credit facilities. It also protect depositors by requiring that deposit taking MFI`s contribute to the deposit protection fund. The association of microfinance institutions in Kenya (AMFI) is a member institution and trade association established in 1999 under societies act by leading microfinance institution in Kenya. Its purpose is to build capacity of microfinance industry in Kenya. AMFI presently has 36 member institution which provide financial services to more than 2,000,000 low middle income throughout Kenya.

2.4.2 Credit Risks

Credit risk is most simply defined as the potential that a borrower or counterparty will fail to meet its obligations in accordance with agreed terms. Credit risk management is the prediction and control of losses due to credit risk. The goal of credit risk management is to maximize financial intermediaries risk adjusted rate of return by maintaining credit risk exposure within acceptable parameters. MFIs needs to manage credit risk inherent in the entire portfolio as well as the risk in individual credits or transactions. The effective management of credit risk is a critical component of a comprehensive approach to risk management and essential to the long-term success of sustainability any MFIs.

Credit Reference bureaus complement the central role played by banks and other financial institutions in extending financial services within an economy. CRBs help lenders make faster and more accurate credit decisions. They collect, manage and disseminate customer information to lenders within a provided regulatory framework. In Kenya, the Banking (Credit Reference Bureau) Regulations, 2008 was operationalized effective 2nd February 2009. Credit histories not only provide necessary input for credit underwriting, but also allow borrowers to take their credit history from one financial institution to another, thereby making lending markets more competitive and, in the end, more affordable.

The Micro finance institutions in Kenya today is faced by the issue of non-performing loans. The growing level of NPLs undermines profitability and growth of MFIs. Koch (1995) found out there is list of problems affecting the financial intermediaries which include: regulatory violations, real estate losses, non-performing loans (NPLs), low existing capital and no sources of additional capital, liquidity problems caused by lost consumer deposits and treasury securities that could not be sold because they were pledged as collateral and lack of any interest rate risk management strategy.

The growing level of NPLs undermines profitability, sustainability and growth of MFIs. This constrains the capacity of MFIs to increase lending, which is critical for economic growth and job creation. MFIs are increasingly facing credit risk in various financial instruments other than loans, including acceptances, trade financing, foreign exchange transactions, financial futures, swaps, bonds, equities, options, and in the extension of commitments and guarantees, and the settlement of transactions.

Since exposure to credit risk continues to be the leading source of problems in financial intermediaries world-wide, MFIs and their supervisors should be able to draw useful lessons from past experiences. MFIs should now have a keen awareness of the need to identify, measure, monitor and control credit risk as well as to determine that they hold adequate capital against these risks and that they are adequately compensated for risks incurred.

MFIs play a central role in extending financial services within an economy. In support of this role, credit bureaus help lenders make faster and more accurate credit decisions. Credit bureaus assist in making credit accessible to more people, and enabling lenders and businesses reduce risk and fraud. Sharing of information between financial institutions in respect of customer credit behavior, therefore, has a positive economic impact.

2.4.3 Geographical Spread and Outreach

Geographical spread is proposed as an important characteristic to gain performance effects in sustainability and success can be regarded as a proxy for resources where larger firms usually possess more product lines and higher lending capacity together with institutional resources.

The microfinance instrument advocates two main ways which are financial systems approach and poverty lending approach. According to (Holt,1994) said that two approaches complement each other to improve access to financial services based on self-help, community based groups that also provide a forum that enables interaction for social purposes. These mutual support group form a basis for building local capacity to manage micro finance institution in a participatory manner with hopes of inspiring similar target group in other areas. The financial system approach aims to achieve a maximum outreach of micro finance services through financially sustainable institutions under this approach provide finance to the public.

MFIs under this approach are therefore differentiated from informal money lenders from unregulated institutions such as NGOs and from subsidized formal micro credit. According to (Robinson 2003) where a regulated institution such as a state-owned bank channels government or donor funds to borrowers at subsidized interest rates, the proponents of the financial systems approach argue that donors and government should shift allocation of their scarce resources from direct financing the development of portfolios to promote replication of this model from the best practices of fully sustainable microfinance institution and financing the development of more

microfinance institution of this type. The challenge of financial systems approach is that it relies on market approaches which may be thin and weak in marginal areas (Pralahad, 2004). However even in those areas market solutions can be found to overcome any obstacles (Elliot and Gibson 2005).Thus, microfinance target group may require both financial and non-financial inputs such as health, education, nutritional support in the case of low income households and business training to help develop micro-enterprises beyond subsistence levels that a minimalist service delivery methodology does not incorporate (Mead, 1994).

The poverty lending approach focuses on reaching the poorest of the poor who are typically engaged in pre-entrepreneurial activities that are more focused on consumption than productivity enhancing activities (Honohan, 2004).This group require assistance inform of income transfers to meet their basic needs because any credit extended to them will most probably consumed rather than invested in something that generates a return sufficient to repay the debt (Rosengard, 2001).The poverty lending approach differs from the minimalist financial services model characterized by financial system approach

The funding services is typically provided by government, donor's grants and other subsidized funds. Previously loan portfolios used to be funded by donors and government and loan provision was subsidized at below market interest rates. The increasing evidence that microfinance target group repayment rates are not affected by market related interest rates has changed the practice of subsidizing interest rates. In addition the use of forced savings has reduced the extent to which donors and government are required to fund loan portfolio even if microfinance target group is not able to save.

2.4.4 Breadth of Outreach of Microfinance Institution

The breadth of outreach refers to the number of poor served by a microfinance institution (Hishigsurem, 2004). There are various studies that have been used by the number of borrowers as a measure of microfinance breadth of outreach (Ganka, 2010; Mersland and Strom, 2009; Harmes et al, 2008). It is generally assumed that the larger the number of borrowers the better the outreach. According to LOGOTRI (2006) larger number of borrowers found to be the biggest sustainability factor, on the contrary, Ganka (2010) on Tanzanian microfinance institutions reports negative and significant relationship between breadth of outreach and financial sustainability.

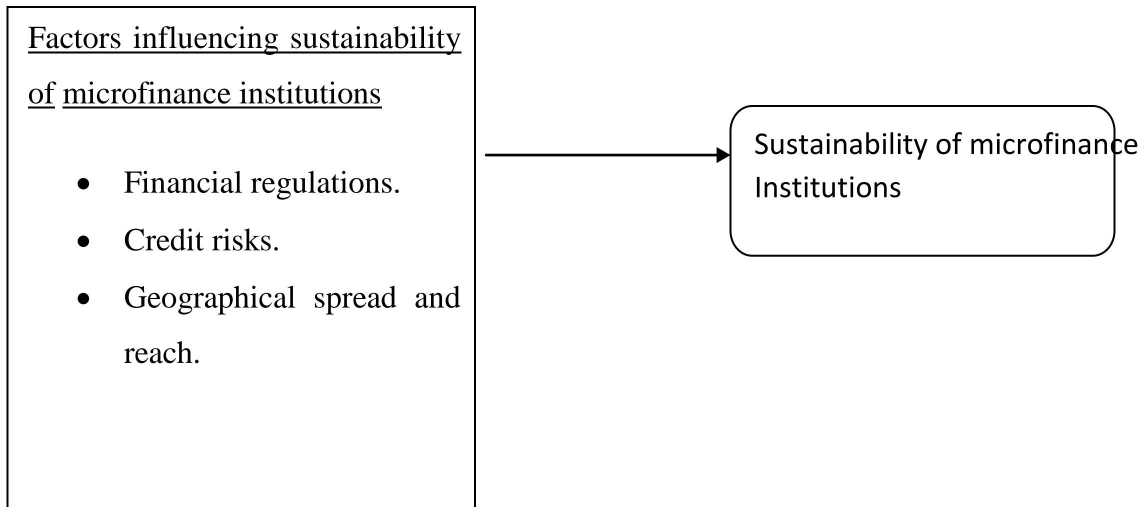
Ganka concludes that increased in number of borrower itself does not improve financial sustainability of microfinance institutions.

2.4.5 Depth of Outreach of Microfinance Institution

According to Hulme and Musley (1996), provides an argument that without the poor the supposed MFI is no longer different from a bank. They argue that outreach should not be measured by just total number of clients but it should rather be based on the number of poor clients. According to Ledgerwood (1999) the number of borrowers as a measure of outreach considers only the total number of clients served from various products of MFIs without their relative level of poverty. Woller and Schreiner (2002) states that the relationship between depth of outreach and financial self-sustainability is multidimensional. In their study they provide an argument that depth of outreach has a positive relationship with financial self-sustainability. Thus, Woller and Schreiners" finding provides an evidence against a wide spread belief that small loans are highly risky and associated with lower financial sustainability.

2.5 Conceptual framework

It is a model that presents and explains the relationship between various variables. According to Kombo & Tromp (2006) state that a conceptual framework is intended to assist the researcher to develop awareness and understanding of the situation under study and communicate it. It helps the researcher to make meaning of subsequent findings and form part of agenda for negotiations to be studied and tested, revived and reformed as a result of investigations (Guba and Lincoln, 1989). In a conceptual framework there are three types of variables: dependent, independent and intervening variable. In this study, the independent variables are the financial regulations imposed on the MFIs, Arsyad (2005) note that bad regulation can stifle an MFI to the point of rendering it out of business while good regulations, geographically spread and lack of non-performing loans enhance its success and sustainability. These independent variables influence sustainability of the MFIs which in this study is the dependent variable.



Independent variables **dependent variables**

Figure 2.1: Conceptual Framework

CHAPTER 3

3.0 METHODOLOGY

3.1 **Introduction**

In this chapter the research design is clearly illustrated. It is organized into the following headlines: research design, target population, sample design, population of the study, sample size and steps and outlines on how data will be collected and analyzed.

3.2 Research Design

This research adopted the descriptive research design. Descriptive design was used to outline the features of the population interest, make estimations in the population and also come up with the predictions. Descriptive characteristics of the population was based on description of the characters. Survey technique was involved in the collection of primary data about subjects, by targeting the chosen sample, and through the use of questionnaire.

The study focused on the important population and ignores the irrelevant ones. This was to improve the accuracy and efficiency of estimation. Surveys and questionnaires were flexible in the sense that a wide range of information can be collected. Secondary data was collected from the MFIs periodic journals, newspapers, annual reports relevant reference books and more so from relevant web pages posted on the internet.

3.3 Population of study

The target population of study was 200 individuals who comprised all the micro finance institutions operators and all the field officers of the institutions in Narok County.

3.4 Sample Size

Lavrakas (2008) describes a sample in a survey research context as a subset of elements drawn from a larger population. Kombo and Tromp (2009) and Kothari (2004) also describe a sample as a collection of units chosen from the universe to represent it. According to Kombo and Tromp (2006), a sample size of at least 10% or 20% 0f the population is considered reasonable for the findings of the study to be valid. The sample size of the study consisted of 40 respondents who are

micro finance institutions operators and field officers of the micro finance institutions in Narok town so as to obtain the relevant data on the subject matter. Stratified sampling was used in the selection of the field officers.

3.5 Data Collection Instruments

This study was facilitated by the use of primary data which was collected from managers and field staffs of the institutions using structured questionnaire. The questionnaire addresses the objectives of the study. Secondary data was obtained from various magazines, newspapers, libraries, journals, brochures and any other document to be used during the research.

3.6 Data Collection Methods

The questionnaire was delivered physically to all potential respondents. It was administered through a drop –and -pick –later approach. This means that once the questionnaires have been dispatched to the relevant respondents, they were picked up at a designated time and place.

3.7 Data Analysis

Data analysis entails arranging data, and breaking it into smaller units. It involves working with data, organizing it, breaking it into manageable units, synthesizing it, search for patterns, discovering what is important and what is to be learned, and deciding what to tell others. Depending on the data that was obtained from the questionnaire it was grouped basing on the research questions and analyzed by descriptive statistics such as percentages, mean scores and standard deviations and the results were presented in frequency table. The statistical package for social sciences (SPSS) will be instrumental in establishing the data associations, which eventually lead to conclusion of objectives of the study. Regression analysis was used to show the relationship between variables.

3.7.1 Analytical model

Multiple linear regression models using ordinary least square stepwise method was applied to investigate the factors influencing sustainability of microfinance institutions in Narok County.

The regression model was of the form:

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \varepsilon$$

Where: Y= MFIs sustainability

β_0 = Constant Term

β= Beta Coefficient

X1= Financial regulations

X2= Credit risk controls

X3 =geographical spread

3.8 Data analysis techniques

On completion of data collection, the researcher checked for completeness of the questionnaires. The data was arranged and grouped according to particular research questions. Quantitative data was obtained by use of statistical package for social sciences (SPSS). Data entry and initial analysis was done with the help of data programmes. Coding categories was developed for organizing and sizing qualitative data collected according to research questions.

CHAPTER 4

4.0 DATA ANALYSIS RESULTS AND DISCUSSION

4.1 Introduction

This chapter presents data analysis, findings and interpretation of the research. From the sample population targets of 40 respondents. 30 respondents responded and returned the questionnaire, constituting 75% response rate.

4.2 General Information

Table 4.1 The gender of the respondent.

The study found that the respondents were from both genders.

Gender	Frequency	Percent %
Male	20	66.7%
Female	10	33.3%

From the study the majority of respondents were male as shown by 66.7% of the respondents, the female constituted 33% of the respondent. This information is shown in figure 4.1

Figure 4.1: gender of the respondent.

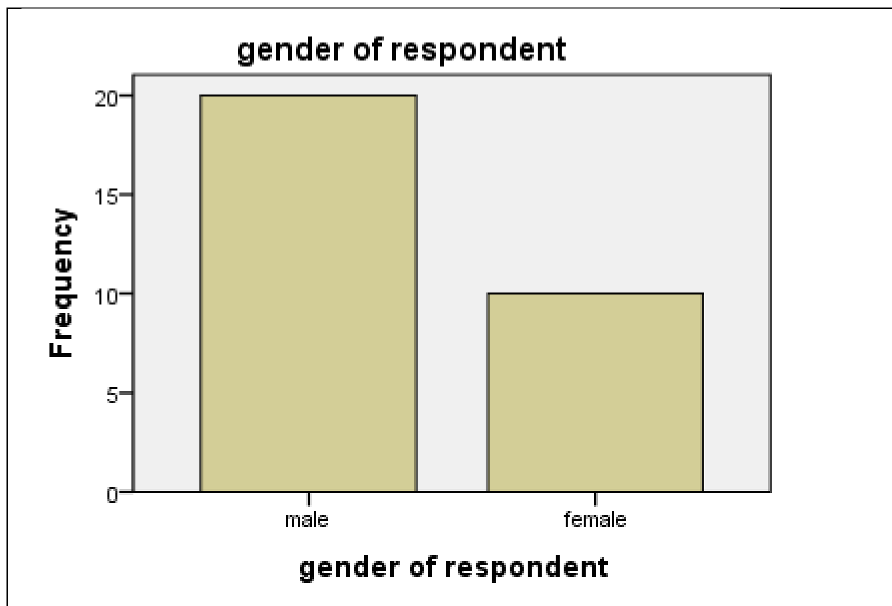


Table 4.2: The age of the respondents.

AGE	Frequency	Percent%
Above 60	3	10
51-60	9	30
41-50	8	26.7
31-40	6	20
21-30	4	13.3
	30	100

From the study it shows that the majority of the respondents were aged 51-60 as shown by 30% of the respondent. 26.7% of the respondent were aged 41-50 years, 20% of the respondents were aged 31-40, 13% of the respondents were aged 21-30 years and 10% of the respondent involved the least respondent aged above 60 years. This information in the above table was shown in the figure 4.2 below.

Figure 4.2: Age of the respondent

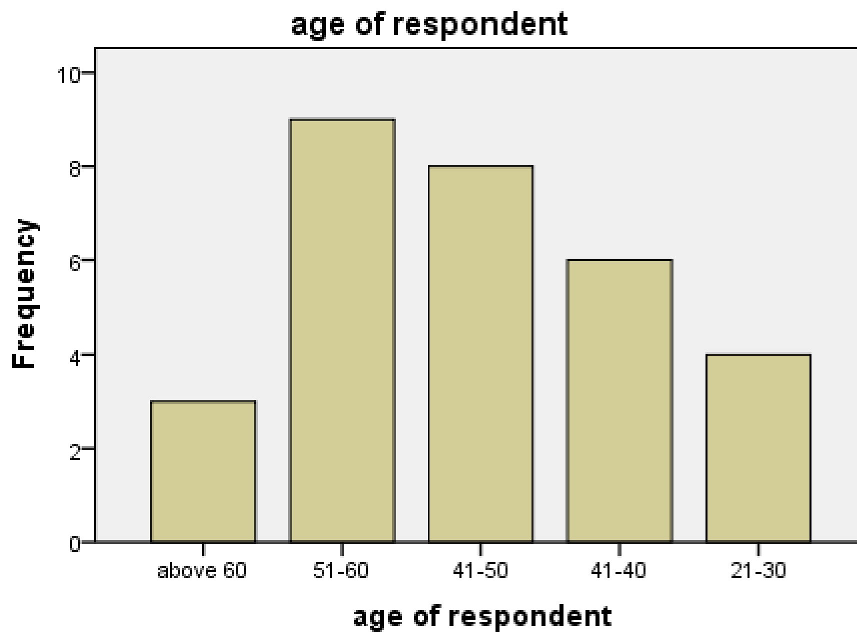


Table 4.3: Duration the firm has been in operation in Kenya**.**

	Frequency	**Percent**
5-10 years	15	50
11-15 years	10	33.3
Over 15 years	5	16.7
Total	30	100.0

The study sought to find out the duration that the firms had operated in Kenya. From the study, the majority of the MFIs had been operating in Kenya for 5-10 years as shown by 50% of the respondents, 33.3% of the firms had been operating in Kenya for 11-15 years while 16.7%% of the firms had been operating in Kenya for over 15 years. This information was also shown by the figure 4.3

Figure 4.3: Duration the firm has been in operating in Kenya

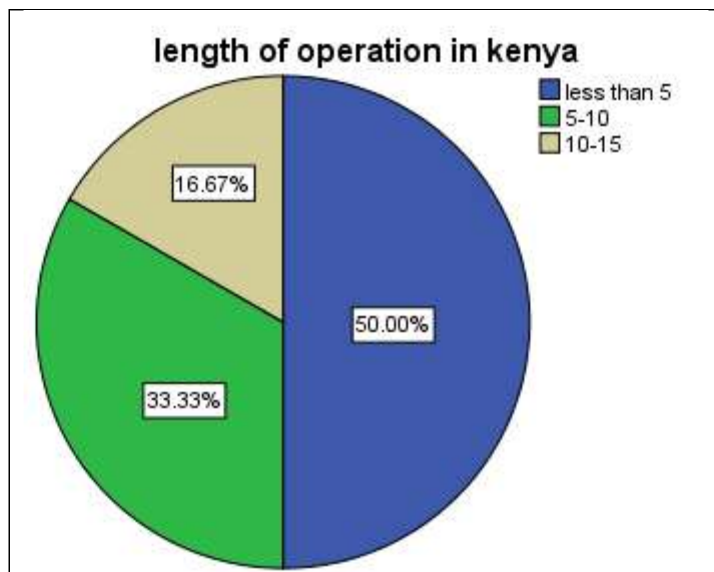


Table 4.4 Duration the Firm has been in Operation in Narok Town.

	Frequency	Percent
Less than 2 years	3	10.0
2-5 years	12	40.0
6-10 years	8	26.7
Over 10 years	7	23.3
Total	30	100.0

The findings in the table 4.4 shows the duration the microfinance institution had been operating in Narok town. From the study, the majority of these firms as shown by 40.0% of the respondents had been operating in Narok town for 2-5 years, 26.7% of the firm had been operating in Narok town for 6-10 years, 23.3% of the firms had been in operation in Narok town for over 10 years, while 10% of the firms had been operating in Narok town for less than 2 years. The information in the above table was also shown in the pie chart below.

Figure 4.4: Duration the firm has been in operation in Narok town.

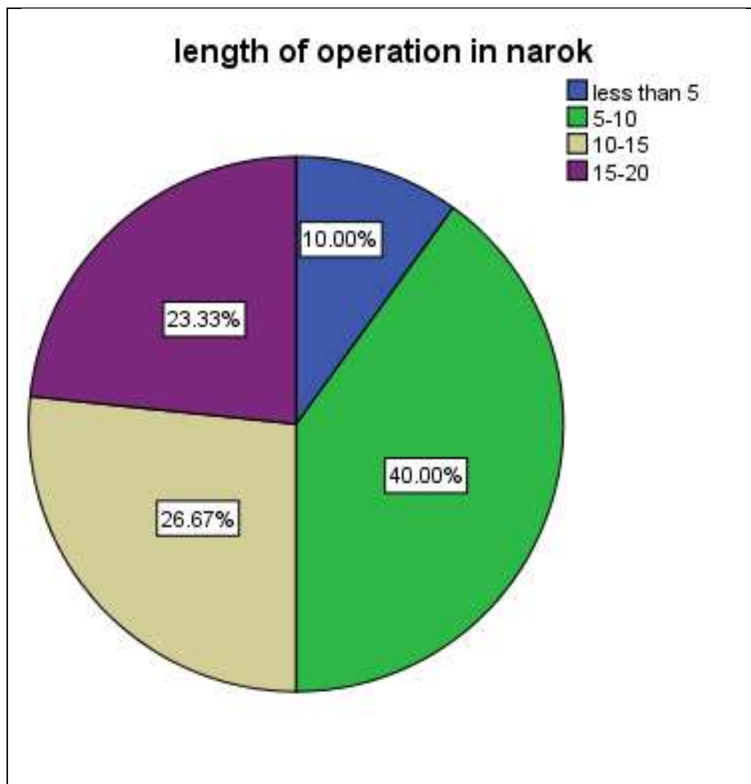


Table 4.5 Mode of maintaining the records

	Frequency	Percent
Manually	5	25.0
Use of computers	25	75.0
Total	30	100.0

The findings in the table 4.5 show how the records in the microfinance institutions were maintained. From the study, the majority of the firms as shown by 75% of the respondents maintained their records by use of computers, while 25% of the institutions maintained their records manually. The above information was also represented in figure 4.5

Figure 4.5 Mode of maintaining the records

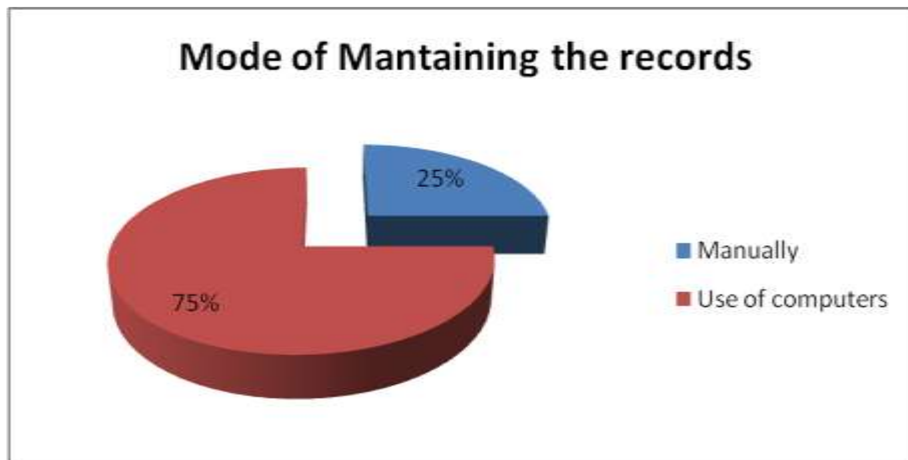


Table 4.6: Donors of the Institutions

	Frequency	Percent
Members of SACCOS	20	66.7
Churches and other institutions	7	23.3
Individual owners	3	10
Total	30	100.0

The study also sought to find out who the donors of the micro finance institutions in Narok were. From the finding the majority of the respondents reported that the institutions were financed by

the members or SACCOs as indicated by 66.7% of the respondents. 23.3% of the respondent said that they were financed by churches and other institutions, while 10% of the respondents said that the institutions were financed by the individual owners. This information was also shown in figure 4.6

Figure 4.6: Financer of the Institutions

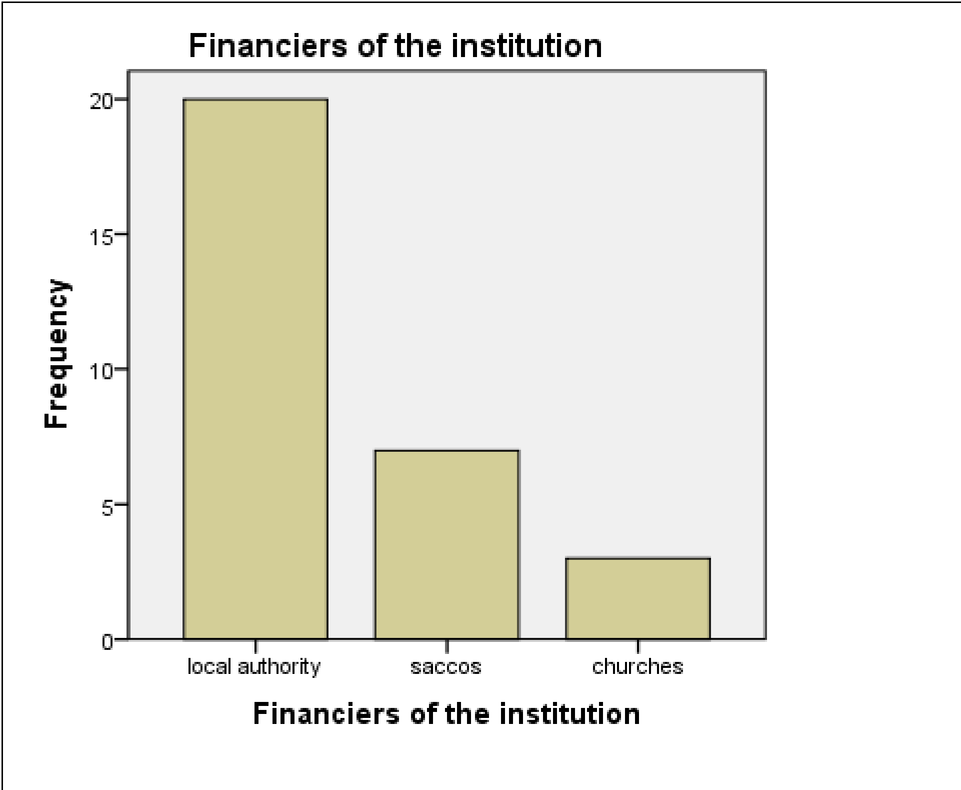
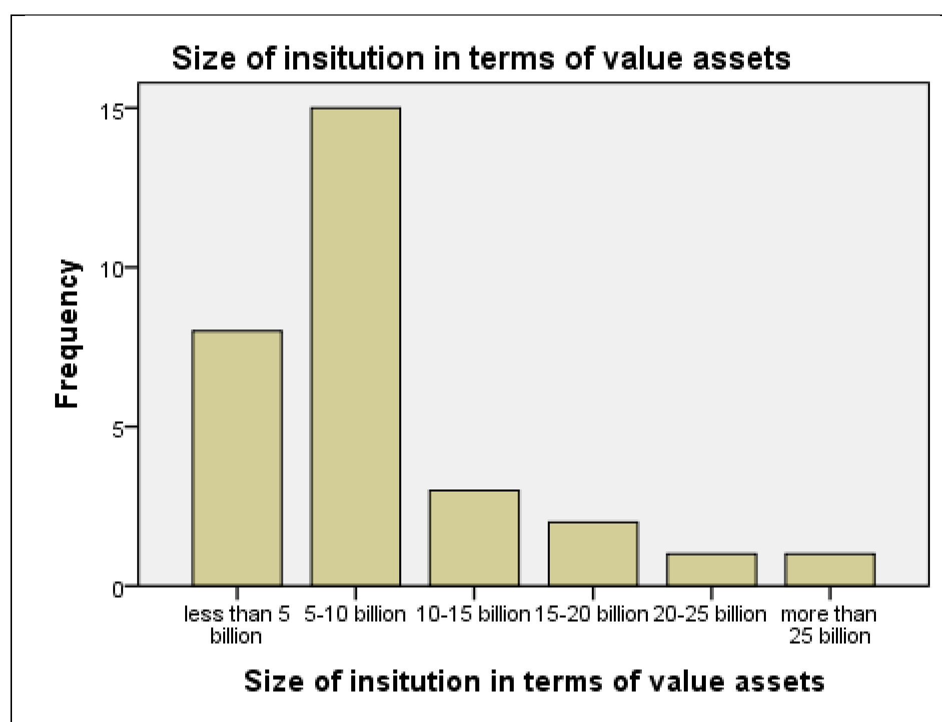


Table 4.7: Size of MFIs in Terms of Value Assets.

Size of MFIs in terms of value asset	Frequency	Percent %
Less than 5 billion	8	26.7%
5-10 billion	15	50%
10-15 billion	3	10%
15-20 billion	2	6.7%
20-25 billion	1	3.3%
More than 25 billion	1	3.3%

The findings revealed that 50% of MFIs own assets to amounts 5-10 billion Kenyan shilling. The rest of the share the remaining 50% at the ranges of less than 5 billion KShs 10-15 billion KShs, 15-20 billion KShs, 20-25 billion KShs and more than 25 billion Kenya shillings. This is shown in figure 4.7 below.

Figure 4.7: size of the institution in terms value asset



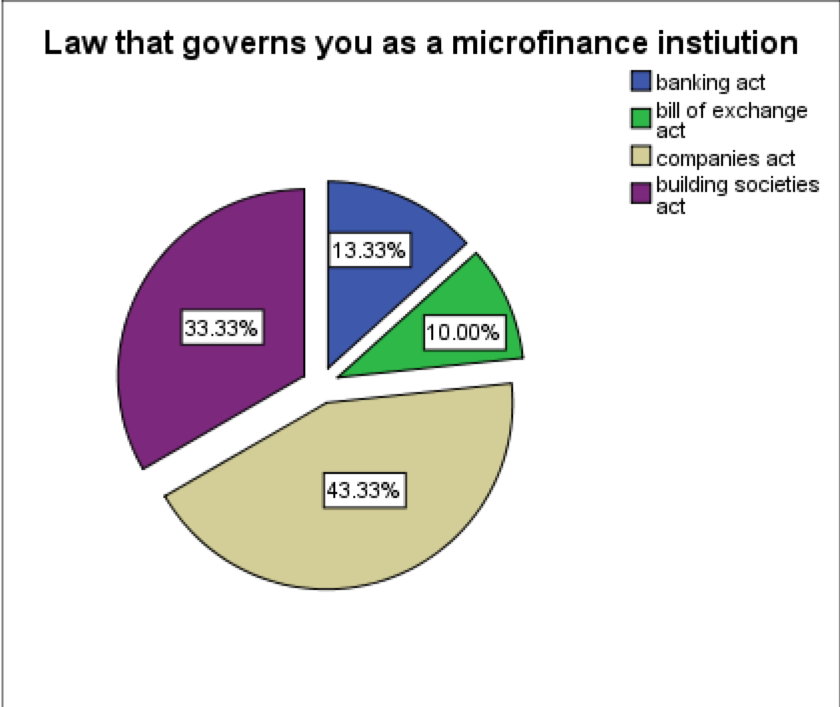
4.3: Financial Regulations

Table 4.8: The regulations that Governs the microfinance Institutions in Kenya

	Frequency	Percent
Banking act and central banking of Kenya act	4	13.3.
Building societies act	3	10
Association of microfinance institutions (MAFI)	13	43.3
Microfinance act	10	33.3
Total	30	100.00

The respondents were also requested to state the regulation that coverers the role of microfinance institutions in Kenya. According to the findings, the majority of the respondents as shown by 43.3% felt that the role of microfinance institutions in Kenya was covered was covered by the Association of microfinance institutions (AMFI), 33.3% of the respondents were of the view that they were covered by Microfinance Act, 13.3% said Banking act and central banking of Kenya act, while 10% of the respondents said that the microfinance institutions were covered by the building societies act. The pie chart in figure 4.8 was also used to represent this information.

Figure 4.8: The regulation that governs the microfinance institutions in Kenya.



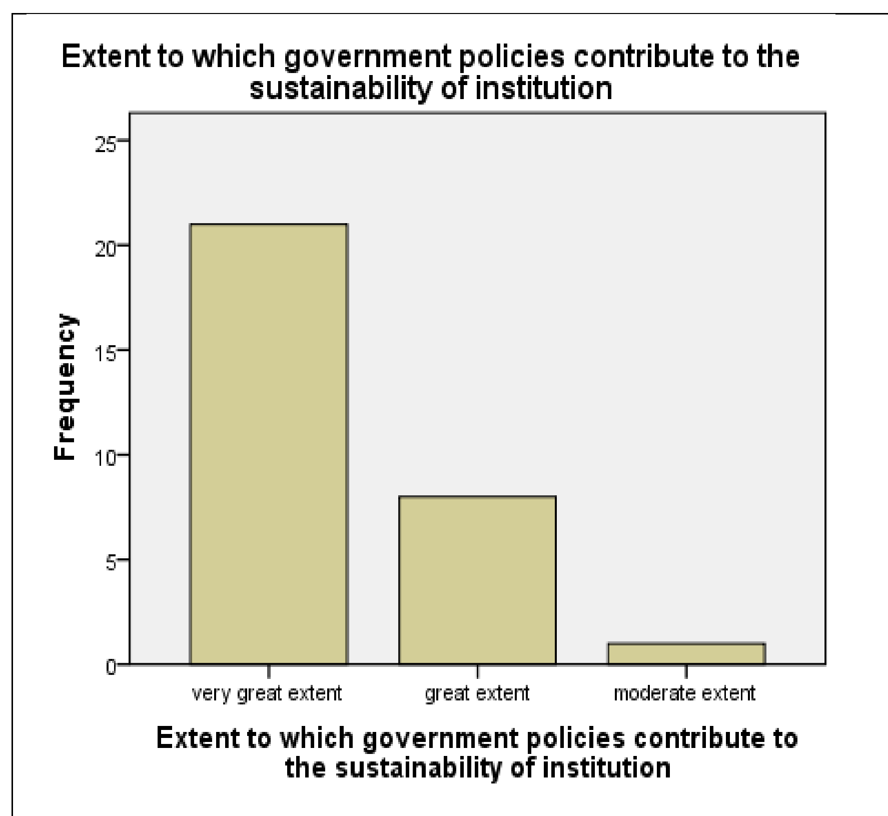
The respondents were also requested to indicate whether there was a body that supervises microfinance institutions. From the study, all the respondents reported that there was a body that supervised the microfinance institutions. These bodies include; the Central bank of Kenya. The regulations that govern the microfinance institutions have a great effect on their operations as they regulate and supervise their operations to protect customer's deposits, and to ensure that reckless lending does not threaten the stability of the wider financial system. The regulatory authorities also react to political pressure to regulate and supervise microfinance institutions operations

Table 4.9: Extent that the government policies in the operations contribute to the sustainability of the institution

	Frequency	Percent (%)
Very great extent	21	70.0
Great extent	8	26.7
Moderate extent	1	3.3
Total	30	100.0

The study also sought to find out the extent that the government policies in the operations contribute to the sustainability of the microfinance institutions. From the study, most respondents as indicated by 70% reported that the government policies contribute to the sustainability of the institutions to a very extent, 26.7% of the respondents said to a great extent, while a small proportion of respondents as indicated by 3.3% said to a moderate extent. This information shows that government policies had a great influence on the sustainability of microfinance institutions. The information in table 4.9 was also shown in the bar chart figure 4.9

Figure 4.9 Extent the Government policies contribute to the Sustainability of MFIs



4.4 Credit Risk

Table 4.10: level of credit experience in terms of years**.**

The research showed that the percentage of MFIs employees that deal with credit management and the number of years they have being involved in such either with their current or previous employers.

Level of credit experience	Frequency	Percent %
Less than 2 years	3	10
2-5 years	9	30
5-10 years	6	20
10-15 years	9	30
Over 15 years	3	10
	30	100

The study showed that 10% of MFIs have a less than 2 years' experience in credit management which means that they may not be actively involved in this activity but know the policies in their MFIs. 30% of the respondents indicated a 2-5 years' experience which shows surety in their responses. 20% of respondents indicated a 5-10 years' experience either with their current or previous employer, their responses are therefore certain and reliable since they hold management posts. A 30%, 10% of respondent have a 10-15 years and over 15 years' experience respectively.

Figure 4.10: Level of credit experience in terms of years

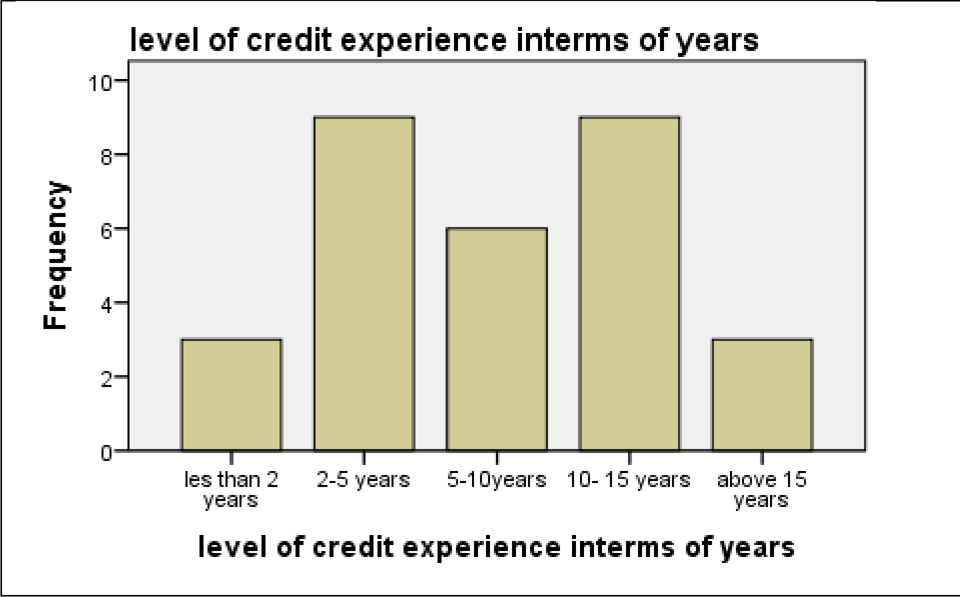


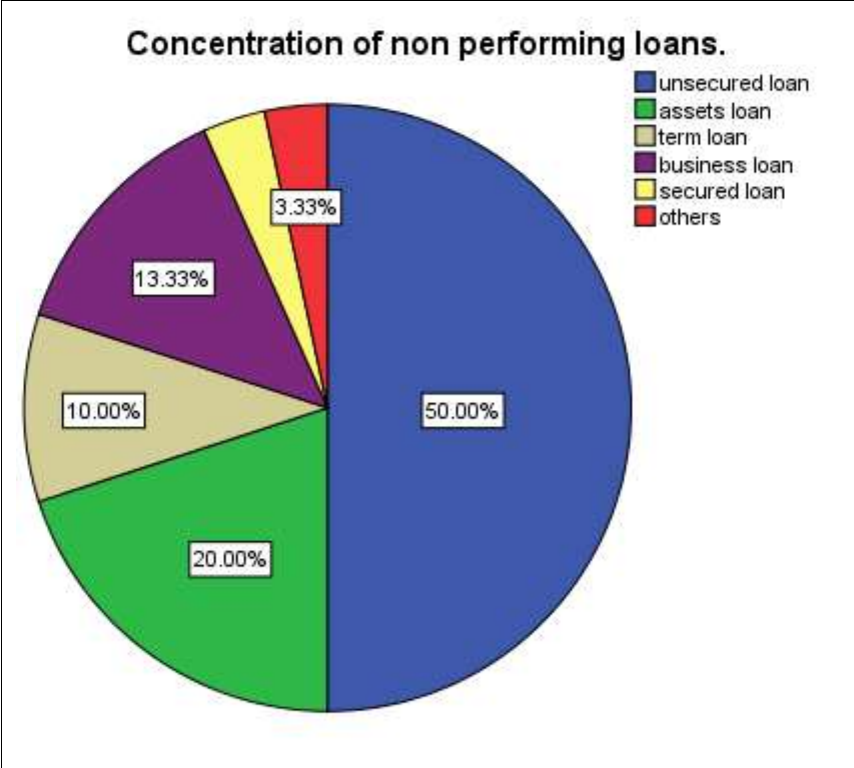
Table 4.11: Concentration of NPLs in Percentage.

The table below reveals that unsecured loans and asset finance loans are highly NPLs**.**

Category of NPL	Frequency	Percent (%)
Unsecured personal loans	15	50%
Asset finance loans	6	20%
Business loans	4	13.3%
Term loans	3	10%
Secured loans	1	3.3%
Others	1	3.3%
	30	100%

From the study it showed that unsecured loans are most notorious with a 50% stake. The research attributes this to the fact that no collateral is required to borrow such loans and the borrowed amount cannot be recovered upon default. Asset finance loans occupy 20% on default. Since they are usually large loans, if defaulted in extreme percentages they can lead to the collapse of MFIs. Business loans have 13% of NPLs, term loan consisted of 10% while secured and others occupy 3.3% of NPLs.

Figure 4.11: concentration of NPLs



4.5: Geographical coverage

Table 4.12: Number of clients that the Microfinance Institutions had by the end of the first Year of operation.

	Frequency	**Percent** (%)
Less than 100	4	13.3
100-200	9	30
201-300	12	40
301-400	3	10
Over 400	21	6.7
Total	30	100.0

The respondents were also requested to indicate the number of clients that the microfinance institutions had by the end of the first year of operation in Narok Town. From the study, the majority of the respondents as indicated by 40% said that their microfinance institution had 201-300 clients by the end of the first year of operation in Narok, 30% of the respondents said that they had 101-200 clients, 10% of the respondents said that they had 301-400 clients, 13.3% of the institutions had less than 100 clients, while 6.7% of the respondents reported that they had over

400 clients by the end of the first year of operation in Narok Town. This information was also shown in the figure 4.10

Figure 4.12 Number of clients that the MFIs had by the end of the first Year of operation

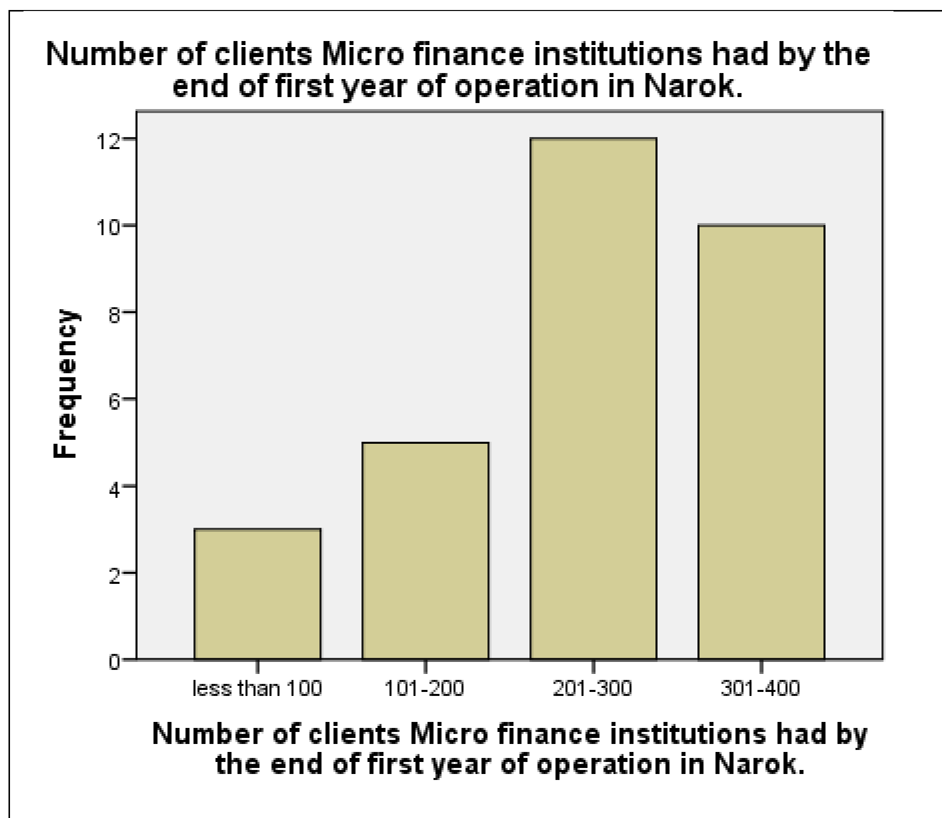
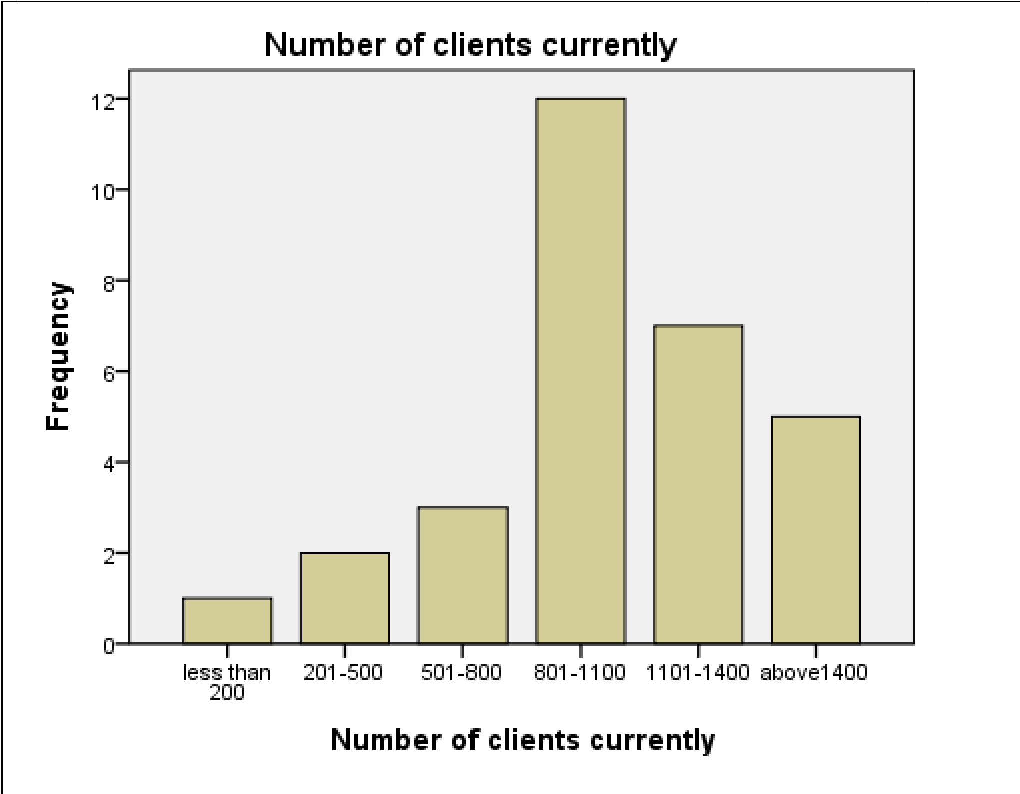


Table 4.13: Number of Clients currently

	Frequency	**Percent** (%)
Less than 200	1	3.3
201-500	2	6.7
501-800	3	10
801-1100	12	40
1101-1400	7	23.3
More than 1400	5	16.7
Total	30	100.0

The study also sought to find out the number of clients that the microfinance institutions in Narok Town have currently. From the study, the majority of the respondents said that in their microfinance institution, they had 801-1100 clients currently this was shown by 40% of the respondents, 23.3% said that they had 1101-1400 clients currently, 16.7% of the respondents reported that thee had more than 1400 clients currently 10% said that they had 501-800 clients currently, 6.7% of the institutions had 201-500 clients, while a small proportion of respondents as indicated by 3.3% reported that they had less than 200 clients currently. This information was also shown in the figure 4.12.

Figure 4.13 Number of clients currently.



4.6 Regression Analysis

A Multiple linear regression model was used to measure the sustainability of MFIs in the study. The prediction was carried out basing on the effect of the three independent factors: financial regulation; credit risks and geographical coverage. The study thus came up with a model summary, the ANOVA and the regression model as presented in table 4.14, 4.15 and 4.16

Table 4.14: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics				
					R Square Change	F Change	df1	df2	Sig. F Change
1	.741[a]	.549	.497	.52223	.549	10.557	3	26	.000

a. Predictors: (Constant), X1, X2, X3

Adjusted R squared is coefficient of determination which tells us the variation in the dependent variable due to changes in the independent variable, from the findings in the above table the value of adjusted R squared was 0.49.7 an indication that there was variation of 49.7% on sustainability of MFIs in Kenya due to changes in financial regulation, credit risk control and geographical coverage at 95% confidence interval. This shows that 49.7% changes in sustainability of MFIs could be accounted for by financial regulations, credit risks and geographical. R is the correlation coefficient which shows the relationship between the study variables, from the findings shown in the table above there was a strong positive relationship between the study variables as shown by 0.741.

Table 4.15 ANOVA[a]

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	8.638	3	2.879	10.557	.000[b]
	Residual	7.091	26	.273		
	Total	15.729	29			

a) Dependent Variable:
b) Predictors:(Constant), , X1, X2 X3
c) From the ANOVA statistics in the above table results show that for this study, $p=0.000<0.05$, which implies that the means of the independent variables and the dependent variable are statistically different from each other at the 95% significance level.

Table 4.16: Coefficients.

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	.584	.414		1.413	.170
X1	.192	.108	.261	1.782	.086
X2	.346	.123	.434	2.821	.009
X3	.192	.125	.243	1.532	.138

From the data in the above table the established regression equation was

$Y = 0.584 + 0.192X_1 + 0.346\ X_2 + 0.192X_3$

From the above regression equation it was revealed that holding financial regulations, credit risks and geographical coverage to a constant zero, sustainability of MFIs would be 0.584, a unit

increase in improvement of financial regulations would lead to increase in sustainability of MFIs in Kenya by a factor of 0.192, a unit increase in credit risk control would lead to increase in sustainability of MFIs in Kenya by a factor of 0. 346 and also unit increase in geographical coverage would lead to increase in sustainability of MFIs by a factor of 0.192

The study also found that all the p-values were less that 0.05 an indication that all the variables were statistically significant in influencing sustainability of MFIs in Kenya.

OTHER FACTORS AFFECTING SUSTAINABILITY

Whether the institutions give financial services to the micro enterprises. The study also established from all the respondents that the microfinance institutions do give financial services to the micro enterprises.

Whether the institutions are properly managed. From the study 40% of the respondents had poor management while 60% had good management leading to success.

How the institutions can sustain their operations in case they do not have donor funds. The study also sought to find out from the respondents how the microfinance institutions can sustain their operations in case they do not have donor funds. From the study, the respondents said that the institutions can use the customer’s savings, they can use the interest from the loans given to their clients and also the institutions can invest in business to help increase their capital in order to sustain them.

The findings also indicated that when micro finance institutions partners with a donor who has the same mission as the institution, sustainability of that institution will be boosted. This is because the micro finance institution will work towards helping fulfill its partner’s mission on a local level while the donor will help in strengthening the capacity of the micro finance institution to carry out its mission.

Challenges Experienced

The respondents were also requested to state the challenges that are experienced in running the micro- finance institutions. From the findings, the greatest challenge was found to be no-payment of loan by the customers. The findings unfolded that inadequate capital will result to unsustainability of the micro finance institutions in the sense that the institutions will not be in a position to cover all of its costs through interest and other income paid by its clients. Other challenges were; Interest rate risk, poor management of the institutions, so much borrowing from customers and also government policies.

Respondent Recommendations on Sustainability

The researcher also requested the respondents to give recommendations on sustainability. From the study, most of the respondents recommended that the institutions should be run by qualified members of the management shown by 90% of the respondents; there should be effective regulation and supervision of the operations of the microfinance institutions shown by 80% of the respondents, the institutions should consider also attracting the most poor people in their regions by giving them loans at much lower interest as shown by 50% of the respondents and also the institutions should have a thorough survey on their customers before they advance loans to them to ensure that the clients is creditworthy.

CHAPTER 5

5.0 SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

From the analysis and data collected, the following discussions, conclusion and recommendations were made. The responses was based on the objectives of the study. The study sought to assess the factors that influence the sustainability of microfinance institutions in Narok County.

5.2 Discussion

From the research, the researcher found that 50% of the micro-finance institutions had been in operation in Kenya for over 10 years and also 23.3% of them had been in operation in Narok Town for more than 10 years. This clearly indicates that these organizations were well versed with the factors influencing the sustainability of these micro-finance institutions as they had been in operation for a considerably long time. It was also clear that 75% of the microfinance institutions maintained their records by the use of computers. According to the study, 66% of the institutions were financed by the members or SACCOs. On financial regulations, according to most respondents, 50% of the microfinance institutions were governed by AMFI regulations. All the micro finances had a body which supervises them according to the respondents. The laws that govern the institutions regulate and supervise the institutions operations to protect customer’s deposits and, ensure that reckless lending does not threaten the stability of the wider financial system and they also react to political pressure to regulate and supervise microfinance institutions operations. The government policies also contribute to the institutions operations, which lead to the sustainability of institutions to a very great extent.

The study found that the challenges that were experienced in running the microfinance institutions were non-payment of loan by the customers, interest rate risk, poor management of the institutions, so much borrowing from the customers and also government policies, which sometimes pose a very great challenge to the institutions. The findings unfolded that inadequate capital will result to unsustainability of the micro finance institutions in the sense that the institutions will not be in a

position to cover all of its costs through interest and other income paid by its clients. The study further unfolded that when interest rates charged by micro finance institutions are unreasonably high, poor borrowers will not afford to repay their loans. Repayment rate is important and the costs associated in recovery of the loans should not be ignored. Interest rate charges are one the main revenue sources of financial revenue for micro finance institution, and therefore should cover the operating expenses besides refinancing expenditure and consider provisions for potential portfolio risk and inflation

5.3 Conclusions

From the findings, the study concluded that the sustainability of microfinance institution is affected by various factors including financial regulations, breadth and depth of outreach, capital structure, credit risks, number of clients, management, government policies as well as donor support. The study concludes that government policies related to MFIs and the supervision of the microfinance institutions influences the success and the sustainability of the microfinance institutions to a very great extent. It was also concluded that the repayment rate from the credit offered also ensures the sustainability of microfinance institutions. Lending to individual clients contribute to higher repayment which is necessary for the sustainability of the MFIs. Geographical coverage influences the sustainability of micro-finance institutions to a great extent. Some of these factors contribute positively to the sustainability of the microfinance institution while others contribute negatively. As the commercialization and securitization of microfinance is in practice along with increase credit need from a large number of low income population, the sector seems to be expanding with promising outreach.

5.4 Recommendations

The study recommends that microfinance institutions should open many branches so that they can be able to reach as many as possible clients which will enhance their sustainability. For microfinance institutions to survive well in the market, the study recommends conformity to rules and regulations regarding registration. They should be run by qualified members effective regulation and supervision of the operations and considering attracting the poor people in their regions by giving those loans at much lower interests.

5.5 Recommendations for Further Research

From the above findings, conclusion and recommendation the study recommends that an in-depth study should be carried to determine the contribution of microfinance institutions in the Kenyan economy. The response rate should be broadened in further studies in order to get more responses so that the researcher can make better generalizations.

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APPENDICES

Appendix 1: Letter of Introduction

Letter of Introduction

Francis Kamau,

P.O Box 861-20500.

Narok.

TO WHOM IT MAY CONCERN

Dear Sir/Madam,

RE: APPLIED QUESTIONNAIRE

I am a student at Maasai Mara University undertaking a Degree of Bachelor of Arts (Economics). I'm currently undertaking research project on the factors influencing sustainability of Microfinance institutions in Kenya as a partial fulfillment of my degree requirements.

Attached herewith is a questionnaire that I am requesting to be completed. All the information you will provide will remain strictly confidential.

If you are interested in the findings of this research, it shall be mailed to you upon request.
Your cooperation and existence will be highly appreciated.

Sincerely,

Francis Kamau.

QUESTIONNAIRE.

This questionnaire seeks to collect information on the factors affecting the sustainability of Microfinance institutions in Narok. Pease provide information in the space provided. All the information will be treated confidentially and will only be used for academic purposes.

SECTION A: GENERAL INFORMATION

1. Name of the institution.

…………………………………………………………………………

2. Gender of respondent

   Male ( )

   Female ( )

3. Age of respondent

   Above 60 years ( )

   Between 51-60 years ( )

   Between 41-50 years ( )

   Between 31-40 years ( )

   Between 21- 30 years ( )

4. Length of operation of organization in

   a) In Kenya

      Less than 5 years { }

      5-10 years { }

      10-15 year { }

      15-20 years { }

      Above 20 years { }

   b) In Narok

      Less than 5 years { }

      5-10 years { }

      10-15 years { }

15-20years { }

Above 20 years { }

5. How many full time employees does the organization have?

- Less than five { }
- 5-10 { }
- 11-15 { }
- 16-20 { }
- 21-25 { }
- 26-30 { }
- over 30 { }

6. How are the records maintained?

- Manually { }
- Use of Computers { }
- Others { }

7. Who are the financiers of the institution?

- Local authority { }
- Members or SACCOS { }
- Churches { }
- Individual owners { }

Other institutions, (Please mention)

…………………………………………………………………………………………

8. Size of the institution in terms of value assets.

Less than 5 billion { }

Ksh. 5-10 billion { }

Ksh. 10-15 billion { }

Ksh 15-20 billion { }

Over 20 billion { }

9. Does the institution have bad debts?

SECTION B: FINANCIAL REGULATIONS

10. Which laws governs you as a microfinance institution in Kenya?

- Banking Act and Central Banking of Kenya Act { }
- Bills of exchange Act { }
- Companies Act { }
- Building Societies Act { }

11. Is there a body which supervises your institution?

- Yes { }
- No { }

Please specify?

…………………………………………………………………………..

12. What are the effects of such laws to the institution's operations?

……………………………………………………………………………

……………………………………………………………………………..

……………………………………………………………………………..

13. To what extent does the Government policies on your operations contributes to the Sustainability of the institution? Use the point scale below.

- Very great extent 5 { }
- Great extent 4 { }
- Moderate extent 3 { }
- Less extent 2 { }
- No extent 1 { }

Section C: Credit Risks

14. How long have you been involved in credit facilities?

Less than 2 years { }

2-5 years { }

5-10years { }

10-15 years { }

Over 15 years { }

15. Does the credit policy require use of customer referencing information from CRB before the issuance of consumer and micro finances loans?

    Yes { }

    No { }

    If no why? …………………………………………………………………………

16. Does your institution have any non-performing loans for the past 5 years?

    Yes { }

    No { }

17. Which category would you place non-performing loans

    - Secured loans { }
    - Assets loans { }
    - Term loans { }
    - Business loans { }
    - Unsecured loans { }
    - Others. { }

SECTION D. Geographical spread

18. How many clients did you have by the end of the first year of operation in Narok Town?

    Less than 100 { }

    101 to 200 { }

    201to 300 { }

    301 to 400 { }

    More than 400 { }

19. How many clients do you have currently?

    Less than 200 { }

    201 to 500 { }

    501to 800 { }

801 to 1100 { }

1101to 1400 { }

More than 1400 { }

20. Does your organization have branches in other parts of Narok?

Yes { }

No { }

If yes how many…………………………………………………………………..

21. To what extent do the following factors influence the sustainability of your Institution?

Use the point scale below

- Very great extent 5 { }
- Great extent 4 { }
- Moderate extent 3 { }
- Less extent 2 { }
- No extent 1 { }

Factor	1	2	3	4	5
The number of customers the MFIS serves					
The government policies related to MFIS and financial policies					
The geographical coverage of the institution					
The volume of credit offered to the customers of the MFI					
Management of microfinance’s					
Technology					
Qualification /motivation of staff					

22. What challenges do you experience?

23. What recommendation would you have in sustainability?